



Base Erosion and Profit Shifting: Notes on Implementation in Nigeria

KPMG in Nigeria

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The Base Erosion and Profit Shifting (BEPS) Project, an initiative of the Organization for Economic Co-operation and Development (OECD) and the G20 nations was launched in 2013 to address the issues of profit shifting and tax avoidance by multinational enterprises (MNEs).

The BEPS Project aims to achieve transparency in the tax practices of MNEs globally and restore trust in domestic and international tax systems. Since the final reports on the 15 BEPS Action Points were delivered in 2015, over 135 countries have been collaborating with the OECD/G20 Inclusive Framework on the implementation of the BEPS Project recommendations. For the most part, implementation of the BEPS recommendations requires changes to domestic tax laws of participating nations as well as amendments to the provisions of existing international agreements. Notably, Nigeria is a part of the Inclusive Framework and has committed to the implementation of the recommendations of the BEPS Project.

This newsletter reviews the current state of BEPS implementation in Nigeria with a focus on the 8 Action Points that have been implemented by way of changes to existing legislation, introduction of new Regulations or issuance of Guidelines and Information Circulars by the Federal Inland Revenue Service (FIRS).

Action 1 - Addressing the tax challenges of the digital economy

Most businesses in this era are supported by digital technologies and there are increasingly more online/web-based transactions. As such, the revenues generated slip through established national tax systems which were, traditionally, not designed to capture the complexities of a digital economy. This normally results in little or no tax paid by such global businesses in their host countries, including Nigeria.

To address the challenges of how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries, the OECD Inclusive Framework proposed certain approaches including Significant Economic Presence (SEP), user contribution, marketing intangibles, and global minimum tax.

On 13 January 2020, Nigeria's President signed Finance Bill, 2019 into law. The Finance Act, 2019 ("the Act") amends Section 13 of the Companies Income Tax Act by introducing the concept of SEP. This Section contains provisions relating

to taxation of economic value derived in Nigeria by non-resident companies (NRCs). The amendments provide that the profits of a company, other than a Nigerian company, from any trade or business shall be deemed to be derived from Nigeria if such company has SEP in Nigeria.

The Finance Act does not define what constitutes SEP but vests the Minister of Finance with the power to issue an Order on the matter. The interpretation and factors for SEP stated in the OECD BEPS reports may be adopted to suit the peculiarities of the Nigerian tax landscape.

Action 4 – Limiting base erosion involving interest deductions and other financial payments

As the use of third party and related party interest is one of the simplest profit-shifting techniques available in international tax planning, Action 4 recommends the design of rules that limit deductibility of interest and other financial payments made to third parties and related parties.

The Nigeria's Finance Act restricts the interest deductible on related party loans to 30% of Earnings Before Interest, Tax, Depreciation and Amortisation in an accounting period and provides for a 5-year carryover of any excess that cannot be recovered in any tax year. This provision does not impact foreign companies in the banking and insurance sectors.

Action Point 6 – Preventing allowance for treaty benefits in inappropriate circumstances

Tax treaties are intended to prevent harmful double taxation. However, it has given rise to treaty abuse and "treaty-shopping" arrangements. Action 6 addresses treaty shopping through new treaty provisions which include specific rules and recommendations to address other forms of treaty abuse.

Nigeria became a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (Multilateral Instrument or MLI) in August 2017. However, the country is yet to deposit her instrument of acceptance with the OECD.

Meanwhile, the FIRS in December 2019 issued an Information Circular on claim of tax treaty benefits in Nigeria. The Circular provides guidance and clarity on the determination of benefits under different tax treaties, and the requirements and procedure for accessing such benefits.

Action Points 8 to 10 – Aligning Transfer Pricing (TP) outcomes to value creation

Actions 8 to 10 clarify and strengthen the existing standards and provides guidance on the application of the arm's length principle for proper pricing of intragroup support services and hard-to-value-intangibles based on the arm's length principle.

Nigeria has since revised the TP compliance requirements relating to intragroup services, intangibles, capital rich, low function companies, commodities transactions, procurement arrangements etc. The changes were made in the Income Tax (Transfer Pricing) Regulations 2018 ("the revised Regulations"). The revised Regulations also imposes stiff penalties for different types of compliance infringements.

Action 13 – Transfer Pricing documentation and Country-by-Country (CbC) reporting

The BEPS Action 13 report recommends a three-tier standardized approach to transfer pricing documentation. The three documents (master file, local file and CbC Report) will require taxpayers to articulate consistent TP positions and provide tax administrations with useful information to assess TP risks as well as ease the process of carrying out tax audits.

To align with the BEPS Action 13 recommendations on TP documentation and CbC reporting, Nigeria incorporated changes to TP documentation requirements in the revised Regulations. Paragraph 17 (1) of the revised TP Regulations requires connected taxable persons to maintain contemporaneous TP documentation comprising Master and Local files.

In addition, the FIRS published the Country-by-Country Reporting (CbCR) Regulations 2018 in the same year. The CbCR Regulations requires Nigerian headquartered MNE Groups with consolidated revenue of ₦160 billion or above to file the CbC report with the FIRS. Nigerian resident members of MNE Groups headquartered outside Nigeria are required to notify the FIRS of the identity and tax jurisdiction of the entity that will be responsible for filing the CbC report, where the Group have a consolidated revenue of EUR750 million or near equivalent in the domestic currency of the jurisdiction of the ultimate parent entity or surrogate parent entity. Stiff penalties for defaults are also included in the Regulations.

Action Point 14 – Making dispute resolution mechanisms more effective

The outcomes and recommendations of the BEPS Project aims to avoid uncertainties and unintended double taxation. Hence the need to include work on measures to improve dispute resolution mechanisms in the BEPS Project. The recommended measure is the Mutual Agreement Procedure (MAP) which is expected to operate independently from the remedies available under each jurisdiction's domestic tax laws.

In February 2019, the FIRS published guidelines on its MAP. This is a demonstration of Nigeria's commitment to implementing the OECD BEPS minimum standards.

The MAP allows for engagement between the competent authorities of two countries with a subsisting tax treaty in a bid to resolving tax disputes arising from inconsistencies in the interpretation or application of a tax treaty or situation. The adoption of MAP in Nigeria is a welcome development for taxpayers with treaty-related disputes.

Conclusion

Nigeria is keeping pace with the rest of the world in adopting global best practices in relation to taxation. The tax landscape in Nigeria keeps evolving in line with the ongoing global tax reforms. The BEPS implementation roadmap has serious implications for businesses in terms of structuring related party transactions, compliance burden, tax deductions, etc. Businesses should continue to assess the impact of the legislative changes triggered by the BEPS Project and its recommendations, and proactively prepare to deal with them.

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